IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

No. 632

RUSSELL W. McDERMOTT,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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BRIEF.

CASES CITED.

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PETITION.

Russell W. McDermott, Petitioner herein, respectfully prays to this honorable Court that a Writ of Certiorari issue to review the Decree of the United States Circuit Court of Appeals entered in the above entitled cause on November 11, 1942 (R. 259) affirming an Order and Judgment of the District Court of the United States for the Southern District of Indiana (R. 226).

The opinion of the Circuit Court of Appeals appears in the record at pages 252-8. The District Court rendered no opinion.

Petition for Rehearing and supporting brief were filed in the United States Circuit Court of Appeals for the Seventh Circuit, which petition was so filed on the 20th day of November, 1942 (R. 261-6), and overruled by said Circuit Court of Appeals without opinion on the 8th day of December, 1942 (R. 270).

Summary of the Matter Involved.

Summarily stated the petition involves the following matters:

1. The constitutional validity of Sections 7 and 8 (a) of the Securities Exchange Act of 1934 as amended, 48 Stat. 886-889, 15 U. S. C. A. #78 (g), (h) attempting to delegate to the Board of Governors of the Securities and Exchange Commission authority to promulate rules and regulations and amend, revise and supplement the same from time to time and attempting to make violations of such rules and regulations criminal offenses, and also paragraph 78 ff (a) prescribing penalties.

2. The force, effect and validity of Regulation T adopted by the Board of Governors of the Federal Reserve System pursuant to the above act.

3. The effect of the holding of the Circuit Court of Appeals that there was substantial evidence warranting the submission of the case to the jury on Count 12 of the indictment where such holding was predicated clearly and without contradiction upon an oversight of the court to credit account in the name of James Allio with two items aggregating $18,711.12, which credits if considered by the court would have left in the account a surplus over and above the amount of security required by the rules of the Board of Governors of the Federal Reserve System.

4. The effect of the holding of the Circuit Court of Appeals that there was substantial evidence of the misappropriation of United States Treasury bond 31022B in

the face amount of $10,000 where the uncontradicted evidence of the witnesses produced by the government and supported by the evidence of witnesses produced by the defendant showed that there was no such misappropriation, but that the proceeds of said bond were properly applied on the account for which it was held as shown by the oral testimony of the government's witnesses and the written exhibits introduced in evidence by the government.

5. The effect of the holding of the Circuit Court of Appeals that there was sufficient evidence to warrant the submission to the jury, the question of the misappropriation of United States Treasury bond 1199K of the par value of $5,000 in the face of the oral testimony of the owner of said bond produced as a witness for the government and her written receipt introduced in evidence by the government showing that there was no misappropriation of such bond, and that the proceeds thereof were properly and fully and honestly turned over to her.

Basis Upon Which It Is Contended That This Court Has Jurisdiction to Review the Judgment or Decree in Question.

It is contended that this court has jurisdiction to review the judgment or decree in question for each of the following reasons:

1. The Circuit Court of Appeals in this case has decided the validity of important provisions of the Securities Exchange Act of 1934 as amended including its penalty provisions and the force and effect of the rules and regulations, and particularly Regulation T of the Board of Governors of the Federal Reserve System, all of which is an important question of federal law which has not been, but should be, decided by this court.

2. An injustice has been done the petitioner which deprives him of his liberty, through an oversight or omission

of the Circuit Court of Appeals to credit the account in question with a substantial sum, towit, $18,711.12 and in the absence of which oversight the evidence would conclusively show that there was no violation of the Securities and Exchange Act referred to, or the regulations promulgated by the Board of Governors of the Federal Reserve System thereunder, as charged in either of the counts of the indictment numbered 10 to 14 inclusive.

3. An injustice has been done the petitioner which deprives him of his liberty in holding that there was a misappropriation of United States Treasury bond 31022B in the face amount of $10,000 and bond No. 1199K in the face amount of $5,000 where the uncontradicted evidence of the witnesses produced by the government including the evidence of the owner of said bonds, and written documents introduced in evidence by the government showed that there was no such misappropriation, and in the absence of which there was no evidence to support counts 1 to 9 inclusive of the indictment.

The Questions Presented.

The questions presented hereunder are as follows:

1. The validity of the portions of the Securities Exchange Act of 1934 and amendments including its punitive provisions as hereinabove referred to and the force and effect of the regulations of the Board of Governors of the Federal Reserve Board made pursuant thereto and particularly Regulation T and the amendments of said Regulation T.

2. The force and effect of a decision by the Circuit Court of Appeals which is based upon an error or oversight of the court to consider a substantial credit vital to the question of the sufficiency of the evidence to sustain the verdict and judgment on counts 10 to 14 inclusive of the indictment.

3. The evidence as shown by the record in relation to the misappropriation of the bonds above mentioned in this petition and the holding of the Circuit Court of Appeals in relation thereto.

Reasons for Allowing the Writ.

The Writ of Certiorari should be granted in this case for the following reasons:

1. The Circuit Court of Appeals has decided, and we believe erroneously decided, the question of the validity of the Securities Exchange Act of 1934 and amendments or certain provisions including the punitive provisions thereof, which is an important federal law which has never been decided by this court and should be decided by this court. So also should this court decide the force and effect of the regulations adopted by the Federal Reserve Board pursuant thereto, and particularly Regulation T, to the end that persons engaged in the brokerage business may be informed of the force and effect of such regulations.

2. Where life or liberty is involved, the discretion of this court should be exercised in a case wherein the evidence in the record shows that there is no substantial evidence to support the judgment of the Circuit Court of Appeals. In the case at bar when mathematical errors or inadvertent omission of credits are eliminated, there is no evidence in the record to support a conviction under either of the counts of the indictment numbers 10 to 14 inclusive, and under the clear and unmistakable evidence produced by the government and corroborated by the evidence produced by the defendant, there was no misappropriation or conversion of either of the government bonds mentioned in the opinion of the Circuit Court of Appeals numbered 31022B in the face amount of $10,000 and 1199K in the face amount of $5,000 nor of any other money, property or right of any other person, and not sufficient evi-

dence to sustain a conviction under either of the counts of the indictment numbered 1 to 9 inclusive.

Substantial justice has not been done in this case. The liberty of the petitioner is involved. A supporting brief accompanies this petition in which the points above mentioned will be more fully discussed and need not receive further comment here.

WHEREFORE your petitioner respectfully prays that a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit be issued in this case to the end that the cause may be reviewed and determined by this court, and the judgment of the Circuit Court of Appeals be reversed and that petitioner be granted such other and further relief as may seem proper.

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JOSEPH H. LESH,
JULIUS C. TRAVIS,
Of Counsel.

BRIEF.

The Constitutional Validity of Certain Sections of the Securities Exchange Act of 1934 as Amended and the Force and Effect of the Rules and Regulations Adopted by the Board of Governors of the Securities and Exchange Commission.

The defendant, by his demurrer to the Counts above indicated, attacks each of said Counts on the grounds that the attempted delegation by Congress of power to the Board of Governors of the Federal Reserve System to define criminal offenses is beyond the power of Congress, and is in contravention of the Fifth and Sixth Amendments to the Constitution of the United States, and because the statute, aside from the Regulations, is indefinite and does not define any offense with sufficient certainty, and also because neither of said indicated Counts state facts sufficient to constitute a public offense. (R. 35.)

Each of the above indicated Counts of the indictment alleges that the Board of Governors of the Federal Reserve System, acting "pursuant to and in accordance with Sections 7 and 8 (a) of the Securities Exchange Act of 1934, as amended, for the purpose of preventing the excessive use of credits for the purchase and carrying of securities, did duly prescribe rules and regulations, and from time to time did duly amend, revise, and supplement such rules and regulations, said rules and regulations as so prescribed, amended, revised and supplemented being commonly known and designated as Regulation T.

If the acts charged are unlawful, it is solely because they are in contravention of Regulation T, since no such acts are prohibited by the statute.

The indictment refers to Sections 7 and 8 (a) of the Act.

These are respectively Sections 78 (g) and 78 (h), Title 15, U. S. C. A.

The question we raise is this: "Is that part of the Act which attempts to delegate to the Board of Governors the power to define criminal offenses valid?" We believe that it is not valid. We have found no reported case dealing with this phase of the Securities Exchange Act, but we believe that the principles stated in the case of *United States* v. *Cohen Grocery Company,* 255 U. S. 81 and *United States* v. *Eaton,* 144 U. S. 577, are decisive. Limitations of space forbid quotations from these authorities but we believe that under the principles stated the attempted delegation of power is void. We further call attention to the fact that the indictment does not charge that the rule or regulation T of the Board of Governors was ever promulgated, nor does it charge that the Defendant had knowledge of such rule or regulation. Regardless of who has the burden of proof of knowledge of the Regulation, it would seem that an indictment which would justify a prison sentence would have to charge that the Defendant had knowledge of the Regulation, and failing so to do the indictment would be insufficient as against a demurrer, and the demurrer to Counts 10 to 14, inclusive, should have been sustained for this reason as well as other reasons above stated.

That this attack upon the Regulations of this character is within itself sufficient ground for certiorari is held by this Court in the case of *International Railway Company* v. *Davidson,* 257 U. S. 506, 66 L. ed. 341.

The Holding of the Circuit Court of Appeals That There Was Substantial Evidence Warranting the Submission of the Case to the Jury on Counts 10 to 14 Inclusive, of the Indictment and Particularly Count 12 Thereof.

The opinion of the Circuit Court of Appeals in holding that there was sufficient evidence to warrant the submission of the case to the jury on Count 12 of the indictment is based on the following calculation as set out in the opinion.

> "The evidence further disclosed that from October 1, 1938 to May 26, 1939, the Allio account was a general margin account, and that on March 31, 1939, there had been purchased and were in the Allio account securities having a value of $29,679 and that the debit balance was $24,464.16. On that day a check for $8,000 was issued to Allio, leaving him owing $32,464.16, against the cost of securities valued at $26,679. On April 1 there was sold in the account 600 shares of stock for $12,778.23, which left the account owing $19,685.93 and securities in the account having a total market value of $9,400. That same day there was purchased in the account 300 shares of Montgomery Ward & Co. preferred stock for $13,926, payment for which was not made except by the sale of the 300 shares of Montgomery Ward & Co. stock on April 5, 1939. Deducting the $9,400 value from the debit balance of $19,685.93 left a deficiency in the account, before the purchase of the Montgomery Ward stock, of $10,285.93."

This computation of the Court is based upon an error or oversight of the Court to take into account certain vital factors, including a deposit of $8,000 to the account of Allio to the firm (Govt's. Exhibit 11 K) and also a credit in the sum of $11,211.12 for the protection of the account in the form of United States Treasury Bond #31022B in the face amount of $10,000 but of the actual cash value of $11,211.12 making a net error in the computation used by the Court as shown by the record in the sum of $18,711.12

leaving in the account an amount over and above that required by the regulation of the Board of Governors.

The opinion states that during this period "a check for $8,000 was issued to Allio, leaving him owing $32,484.16", whereas the check was in fact $8,500 (Government's Exhibit 11-K) but the opinion and judgment fails to show that on the same day a check for $8,000 was issued from Allio to the firm (Government's Exhibit 11-K), which would make a net error in the opinion of the Court in the sum of $7,500 as an increased equity in the account on this item over and above that shown in the opinion.

The opinion also fails to take into consideration that at the time of this transaction there was the United States Government bond in the face amount of $10,000 but of the actual value of $11,211.12, for the protection of the account making an additional error in the computation of the equity in the account at said time in said amount of $11,211.12. This is the bond that is described under the next succeeding title of this brief and the receipts and documents therein copied and referred to.

The total error of said computation is therefore the sum of $7,500 plus $11,211.12, or a total error of $18,711.12, which not only wipes out all of the deficiency but leaves in the account the amount of security required by the rules of the Board.

That we are analyzing the account correctly may be verified in a summary way by the testimony of Government's witness, Holland, who certainly did not manifest any friendliness to the Defendant, but when confronted by actual facts and figures, testified as follows:

> "Q. Now you talked about this account being 'under water' (a term used by the witness as meaning under-margined) constantly, and I think you said at one time it got up to a point where it was eight thousand dollars under water, did you not?

A. I think I said a maximum of eighty-five hundred.

Q. Eighty-five hundred dollars. Now, assuming that this ten thousand dollar bond, 31022B, that was subsequently sold for in excess of eleven thousand dollars, had been in the Indianapolis guaranteeing that account, from October until April 8th, when it was sold, that condition about the account being 'under water' would not have existed? Isn't that correct?

A. That is true." (R. 89.)

Holding of the Circuit Court of Appeals That There Was Substantial Evidence of the Misappropriation of U. S. Treasury Bond 31022B in the Face Amount of $10,000.

The opinion and judgment of the Circuit Court of Appeals holds that there was a misappropriation of $11,211.12 the proceeds of the sale of U. S. Treasury Bond 31022B to Josephthal & Company and its application to the account carried in the name of James Allio. The evidence showed that with the knowledge and consent and at the request of Marie Langen Sweeney, the owner of the above mentioned bond, a trading account was opened for her in the name of James Allio and that in October, 1938 Government Bond 31022B in the face amount of $10,000 was left by her with the firm of Moore, McLean & McDermott for the use and protection of the account and it was to the liquidation of this account to which said bond was applied as will appear from the following evidence which is not in any way contradicted in the record.

The evidence shows clearly that this bond was acquired by the Defendant, not on April 7, 1939, as stated in the opinion, but in October, 1938, and for the specific purpose to which it was applied at the time of sale, and to support this assertion we refer to the following:

A. The written receipt for the bond signed by Mr. McDermott and given to Mrs. Sweeney is in evidence as Gov-

ernment's Exhibit 518 and Defendant's Exhibit 2, and reads as follows:

> "October, 1938. Mrs. Marie Langen Sweeney. Received $10,000 Tr 3¼-46-44 to be held and used by Mr. McDermott for collateral purposes in account known as Jas Allio or other he may see fit for trading purposes. This bond to be held in Mr. McDermott's possession and not sold until ordered by me unless otherwise it becomes necessary to do so because of market conditions. Understood Richardson McVey auditors will make up audit periodically as see fit to do so. R. McDermott." (Government's Ex. 518, Defendant's Ex. 2.)

B. Concurrently with the giving of said receipt Mrs. Sweeney gave to the Defendant written authorization relating thereto over her signature which appears in evidence as Defendant's Exhibit 3, reading as follows:

> "October, 1938. R. D. McDermott, 40 N. Penn, Indpl. This is giving you authority to use the 10 M Tr Bond for trading purposes as you may see fit. Satisfactory to use Jas Allio or others you may suggest. Also agreed to notify Richardson McVey C. P. A. when activities start and audit be made periodically. Marie Langen Sweeney." (Defendant's Ex. 3.)

C. Mrs. Sweeney in her testimony states as follows: "I don't know whether the receipt mentioned James Allio or not," and after refreshing her recollection from the receipt she further testified: "I know James Allio was mentioned afterwards but I don't recall whether it was mentioned at that time or not." (R. 112, 113.)

The witness Richardson testified that he made an audit of the accounts carried in the names of K. K. Kado, James Allio, Philip Allio, and Russell Faux, and that he furnished a copy of the audit to Mrs. Sweeney and that he later discussed the audit with Mrs. Sweeney. (R. 171.) He then testified as follows:

"At the time I wrote the transmittal letter I knew

these accounts belonged to Mrs. Sweeney. I learned that from Mr. McDermott and had it confirmed by Mrs. Sweeney over the telephone." (R. 172.)

It therefore appears clear that the application of the bond herein described or its proceeds to the James Allio account was strictly in conformity to the purpose for which it was held and did not and could not constitute a misappropriation of the bond or its proceeds.

The Holding of the Circuit Court of Appeals That There Was a Misappropriation of United States Treasury Bond 1199K in the Face Value of $5,000.

United States Treasury Bond 1199K belonging to Marie Langen Sweeney of the actual value of $5,595.28 was sold by the petitioner Russell W. McDermott and with the knowledge and consent of the owner Marie Langen Sweeney, and for the reason hereinafter stated, the proceeds were temporarily deposited to the account of Cecelia McDermott, the wife of Russell W. McDermott, where the proceeds remained for a brief period of time. After the reason for this temporary deposit to the account of Cecelia McDermott had passed, the proceeds were reinvested in Government bonds of the identical type and same amount as the bonds sold and these substituted bonds were turned over promptly to the owner Marie Langen Sweeney.

The undisputed evidence upon this subject as shown by the testimony of Mrs. Sweeney, the owner of the bond, was as follows:

"There was some discussion with Mr. McDermott that day about making some investment in Christ Church bonds. The talk was that the Church bonds would be bought under par and were paying a better rate of interest than the government bonds. McDermott advised me that $4,000 of government bonds would buy $5,000 worth of Church bonds and he recommended this. No decision was reached that day.

Something was said about some of my bonds being put in Cecelia McDermott's account.

Q. Was it your suggestion that one of these bonds might be sold and the proceeds kept available to determine whether or not you should purchase these Church bonds?

A. It wasn't my suggestion. It was Mr. McDermott's suggestion. He asked if it would be all right to do it.

Q. Was that agreed to between you and him?

A. Yes, sir." (R. 118.)

She further testified upon this subject as follows:

"For a period then I didn't talk much to Mr. McDermott as he was in Chicago on account of his father's illness. When I couldn't make up my mind what I wanted to do with the bond in Cecelia McDermott's account I said I wished him to purchase a government bond, instead of the Christ Chuch bonds, and he bought government bonds with it and turned them over to me. That was some time in June, the first time I had been to his office." (R. 119.)

The receipt of Mrs. Sweeney for the substituted bonds was as follows:

"..... 1939: 'Received from Mrs. McDermott the following Treasury 3¼s: 81874D, 4472B, 4473C, 4474D, and 4475E.'

The Court: Does that show where they came from?

The Witness: It says on this receipt: 'These to replace the $5,000 bond sold in Cecelia McDermott's account per my instruction Good Friday.' Signed, 'Marie Langen Sweeney.'" (R. 174.)

Conclusion.

To conform to the rules of this Court requiring brevity we have not amplified upon the points involved but it is sufficient to say that there is much supporting evidence and no conflicting evidence in the record upon these questions and we believe that where the liberty of a citizen of the

United States is involved and the validity of a United States public statute and the force and effect of the regulations of a Federal Board are in question a writ of certiorari should issue and for which we shall ever pray.

Respectfully submitted,

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CITATIONS

509386—43——1

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UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the circuit court of appeals (R. 252–258) is reported at 131 F. (2d) 313.

JURISDICTION

The judgment of the circuit court of appeals was entered November 11, 1942 (R. 259), and a petition for rehearing (R. 261–266) was denied December 8, 1942 (R. 270). The petition for a writ of certiorari was filed January 7, 1943. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended

by the Act of February 13, 1925. See also Rule XI of the Rules of Practice and Procedure in Criminal Cases, promulgated by this Court May 7, 1934.

QUESTIONS PRESENTED

1. Whether the evidence was sufficient to sustain the conviction.

2. Whether the provisions of the Securities Exchange Act of 1934 authorizing the Board of Governors of the Federal Reserve System to promulgate regulations governing the extension and maintenance of credit by brokers to and for their customers and making it a criminal offense to violate such regulations are an unconstitutional delegation of legislative power.

STATUTORY PROVISIONS AND ADMINISTRATIVE REGULATION INVOLVED

The pertinent provisions of the mail fraud statute, the Securities Act of 1933, the Securities Exchange Act of 1934, and Regulation T, promulgated by the Board of Governors of the Federal Reserve System pursuant to Sections 7 and 8 of the Securities Exchange Act, are set out in the Appendix, *infra,* pp. 21–30.

STATEMENT

Petitioner was indicted on March 25, 1942, in the District Court for the Southern District of Indiana on fourteen counts (R. 1–34), the first seven of which charged that he devised a scheme to defraud Marie

Langen Sweeney and other persons unknown to the grand jury and to obtain money and property from them by means of false representations, pretenses, and promises, and that he used the mails in the execution of this scheme, in violation of Section 215 of the Criminal Code (18 U. S. C. 338) (R. 1–19). Counts 8 and 9 charged that in the sale of securities by the use of the mails, petitioner employed the scheme to defraud, and obtained money and property from Marie Langen Sweeney by means of untrue statements of material facts and by omissions to state material facts, in violation of Section 17 (a) of the Securities Act of 1933 (48 Stat. 74, 84–85; 15 U. S. C. 77q (a)) (R. 19–21). Counts 10 to 14 charged that petitioner, while a member of a national securities exchange within the meaning of the Securities Exchange Act of 1934 (48 Stat. 881, 882–883; 15 U. S. C. 78c (1) and (3)), extended and maintained credit and arranged for the extension and maintenance of credit to and for a customer on securities not exempt from registration under that Act, in contravention of Regulation T promulgated by the Board of Governors of the Federal Reserve System pursuant to Sections 7 and 8 of the Act (48 Stat. 881, 886–889; 15 U. S. C. 78g, 78h) (R. 21–33).

Petitioner demurred to counts 10 to 14 on the ground that Sections 7 and 8 of the Securities Exchange Act authorizing the Board of Governors to promulgate regulations governing the permis-

sible limits of credit to be extended by brokers are an unlawful delegation of legislative power (R. 35); the demurrer was overruled (R. 36).

After trial, the jury found petitioner "guilty, as charged in the indictment" (R. 225), and he was sentenced generally to five years' imprisonment (R. 226). The circuit court of appeals affirmed the conviction (R. 259).

The Government's case may be summarized as follows:

Petitioner was a partner in the brokerage firm of Moore, McLean and McDermott, and had almost complete charge of the Indianapolis, Indiana, office of the firm (R. 167; see also R. 128, 129). During the period covered by the indictment—September 26, 1938, to May 31, 1939 (R. 2)—the firm was a member of the New York Stock Exchange (R. 37). Mrs. Marie Langen Sweeney, a housewife who was ignorant of financial transactions, especially those in securities (R. 98, 99, 102, 110), was introduced to petitioner by her husband, who had had previous securities dealings with petitioner (R. 98, 111). In these dealings, Mr. Sweeney, who had no means of his own, had used funds advanced to him by Mrs. Sweeney,[1] and she had also guaranteed his account with petitioner (R. 111). At her suggestion Mr. Sweeney, who had lost large sums of his wife's money, discontinued

[1] Mrs. Sweeney had inherited a sizeable fortune from her first husband (R. 98, 111).

his stock speculations, and thereafter petitioner called Mrs. Sweeney to his office for the purpose of closing Mr. Sweeney's account (R. 98–99, 111). There was a net balance in the account of about $11,000 due Mrs. Sweeney (R. 99, 112). On petitioner's representations that he would recoup past losses and make her a profit, Mrs. Sweeney turned these funds over to him under a power of attorney to trade with them in an account under the fictitious name of K. K. Kado (R. 99, 100, 101).[2] The theory of the Government's case was that petitioner defrauded Mrs. Sweeney in three different ways, as follows: (1) by obtaining and misappropriating certain of Mrs. Sweeney's bonds; (2) by overtrading her account for the purpose of gaining fees and commissions, despite his representations to her that he would "go easy" (R. 100), would "do the best he could," and "would handle everything carefully" (R. 100); and (3) by unloading upon her at prices in excess of the market values certain stocks which his firm had in its own portfolio. In the interest of clarity and orderly presentation, we shall delineate the Government's proof on this aspect of the case in the order noted.

(1) Petitioner and one James G. Allio were close friends (R. 79, 133, 134, 136, 137), and Allio had a trading account with petitioner's firm in

[2] Mrs. Sweeney stated that she desired to use the fictitious name to hide her identity, especially from her husband (R. 99, 112).

which petitioner had a definite financial interest and in which he traded for his personal account pursuant to discretionary powers vested in him by Allio (R. 133, 134, 161). Petitioner's trading in this account was carried on through the "free-riding" of securities and the "matching" or "kiting" of checks[3] (R. 54, 55, 62, 64, 147). These operations and the decline in the market found the account on April 7, 1939, with losses in excess of $11,090.43 (R. 158). Neither petitioner nor Allio had sufficient funds to cover the loss (R. 136, 200). Petitioner thereupon represented to Mrs. Sweeney that her K. K. Kado account was in need of additional margin and secured from her two Treasury bonds, one for $10,000 and one for $5,000, both of which he sold (R. 103–104, 165). The $10,000 bond brought $11,211.12, which was deposited in the Allio account (R. 51), thus wiping out the loss, and the $5,000 bond brought $5,599.29, which was credited to the firm account of petitioner's wife and later deposited by petitioner in the joint bank account owned by him and his wife, the money ultimately being used to pay a bank loan owed by petitioner and in acquiring for petitioner a one-half interest in certain real estate (R. 50, 51, 70, 130, 201). Petitioner attempted to cover his method of acquiring the $10,000 bond by having prepared a series of fictitious pre-dated letters running between himself and Allio, the purport of which was

[3] These operations are discussed at p. 11, *infra*.

that the bond belonged to Allio, and which letters he signed and induced Allio to sign (R. 133, 140; see also R. 53, 66–67). Petitioner attempted to explain his handling of the $5,000 bond on the ground that if the money had been placed in Mrs. Sweeney's account it would have been frozen (R. 195–196; but see R. 53).

(2) As soon as petitioner had persuaded Mrs. Sweeney to turn over the management of her K. K. Kado account to him, he began to overtrade in it. Each trade in securities earned a commission for petitioner's firm payable out of the equity in the account (see R. 43, 51, 160). On the first day alone petitioner purchased a total of 2,000 shares of stock at a cost of $29,496.50, which purchases resulted in an excess over the legally required margin of $526.[4] To meet this deficit, 200 shares of this stock were sold on the same day. The commissions on these transactions was $291, and the total commissions for the first two days of trading amounted to $996, or 8.84 per cent of the original deposit in Mrs. Sweeney's account. (R. 159.) An analysis of her account showed "that frequently securities were purchased one day, sold again the same day, purchased the next day and sold again the next day" (R. 160). A total of 36,497 shares were traded in the account during its life of eight months. The

[4] Margin required by Regulation T was 40 per cent of $29,496 or $11,798 (R. 159). Since the original deposit in the account was $11,272.04 (*ibid.*), there was a deficit of approximately $526 (*ibid.*).

total cost of the purchases was $886,771.87 and the total sales $871,354.24. The trading losses plus interest and taxes amounted to $27,090.27, and commissions earned by petitioner's firm equaled $10,631.50. The commissions when added to the interest charged to Mrs. Sweeney totaled $11,504.02, or $231.98 more than the original deposit in the account of $11,272.04. (R. 159; see also R. 43.)[5]

Petitioner frequently called upon Mrs. Sweeney for more margin (R. 159). On one occasion when she was unable to meet such a call, petitioner drew a check on the firm payable to her in the amount of $7,660 and deposited it to her credit at the Banker's Trust Co. where previously thereto Mrs. Sweeney had had no account (R. 46, 116). Simultaneously, petitioner had her sign a check in the amount of $7,160 payable to the firm and drawn on the same bank (R. 116). The net result of the transaction was to answer the call for margin, so far as the books showed on their face, and to leave Mrs. Sweeney with a credit of $500 in the

[5] The turnover of securities in the account is illustrated by the following analysis of the trading in one security: on October 4, 1938, 100 shares of Alleghany Corporation were bought. They were sold October 7. On January 4, 1939, 500 shares were bought; on January 5, 500 shares; on January 10, 200 shares; on January 11, 300 shares, and on March 9, 200 shares. The stock was sold as follows: 200 shares on March 10; 300 shares on March 13; 100 shares on March 14; 200 shares on May 2; and 100 shares on May 24. (R. 160.)

bank, but with a diminished equity of $500 in her K. K. Kado account (R. 46–47). On other occasions when petitioner called for more margin, a cash account was opened in the name K. K. Kado (R. 160). By virtue of this device the margin requirements could be circumvented in that seven days are allowed to settle a cash transaction (R. 160; see also R. 54). No money, however, was paid on the cash accounts; rather the method known as "free-riding" was pursued (R. 160).[6] Any losses which resulted were transferred, however, to the margin account and the trading continued in that account (R. 160).

(3) Petitioner's firm had in its own portfolio certain securities which had suffered a drastic decline and which had a poor and inactive market (R. 40, 73, 76, 126). All of these securities were traded in on the New York Curb Exchange (R. 124–125, 126). The partners were in disagreement as to how the loss on these securities was to be distributed and as to which of them would undertake the liquidation (R. 78, 125–127). Petitioner suggested to another member of the firm and to the firm's Chicago office manager that he would "work" the securities into a customer's account (R. 76, 78, 126). On April 29 and May 24, 1939, petitioner proceeded to "work" these securities into Mrs. Sweeney's K. K. Kado account

[6] For a description of this method, see p. 11, *infra*.

(R. 73, 77.).[7] They were sold to Mrs. Sweeney at prices ranging from five to eight points over the closing prices quoted on the New York Curb Exchange (R. 73–74, 77, 125–126, 160). These operations netted a profit to the firm, but cost Mrs. Sweeney $2,362.50, the total difference between the quoted prices of the securities and the amount paid for them out of her account (R. 76, 78, 160).

The net result of petitioner's operations in Mrs. Sweeney's account was that she ultimately received less than $100 out of her initial investment of about $11,000 eight months earlier (R. 106–107).

In respect of the violations of Regulation T, the evidence shows that petitioner dealt in the accounts of other persons as his own and in these operations extended to the accounts excessive amounts of credit. As already noted, *supra*, pp. 5–6, petitioner had discretionary authority to deal in the account of James G. Allio and in pursuance of this authority he did trade in the account in large amounts (R. 134). In fact, petitioner admitted in an investigation before the Securities and Exchange Commission that he did all of the trading in the account from July 1938 until the account was closed on May 31, 1939 (R. 150). In addition, petitioner traded in the

[7] He also "worked" some of the securities into the account of one W. Osborn, another customer (R. 77).

account of Phillip Allio, James' brother, which account was opened by James in Phillip's name (R. 137), and also in the account of one Russell Faux, a friend of James; this latter account was opened by James at the suggestion of petitioner (R. 138). Both Phillip Allio and Faux testified that they had nothing to do with the accounts opened in their names; that they did not trade in them and that the accounts were controlled by James Allio (R. 141, 142). Throughout the history of these three accounts James Allio was without sufficient funds to meet the demands made upon him (R. 135, 136). In order to supply the necessary funds to these accounts, petitioner indulged in the practices known as "matching checks" (R. 55, 56) or "kiting checks" (R. 59) and "free riding" (R. 55, 62). The first two terms refer to the practice whereby petitioner would draw checks on the firm payable to Allio in order that Allio would have on deposit funds with which to meet the checks drawn by him to the firm in payment for securities. The term "free riding" describes the practice of paying for a security out of the funds obtained from the sale of it. These practices progressed to such a degree that petitioner took over the management of Allio's bank account to the extent of having Allio issue to him blank checks signed in advance, and petitioner would often deposit checks in Allio's account without even handing them to the latter (R. 136–137). The net result of these operations

was a continuous extension of credit by the firm to the Allio account and the other accounts controlled by him.

In respect of count 10 (R. 21–29), the evidence showed that on May 26, 1939, petitioner extended credit to Allio in the amount of $1,805, which resulted in "under margining" the account by $808.23 (R. 153–154). As to count 11 (R. 29–30), the proof was that petitioner acquired, on April 1, 1939, in a cash account of James Allio, 300 shares of Montgomery Ward stock while the account had a debit balance of $10,285.93 (R. 68, 154, 155). The stock was paid for from the proceeds of the sale of it (R. 68, 154, 155), thus completing a case of "free riding."[8] In respect of count 12 (R. 30–31), petitioner on numerous occasions extended credit in varying amounts to the Allio accounts and purchased securities therefor when the account was undermargined and in the "red" (R. 63, 64, 65, 67, 147, 149, 151, 154).

[8] The details of the transaction were: On March 31, 1939, there were in this account securities of the value of $29,679. The debit balance was $24,464.16. On that date a check, which was not entered on Allio's ledger, for $8,000, was issued to Allio, thus increasing the debit balance to $32,-464.16. On April 1, 1939, stocks of the value of $12,778.23 were sold out of the account leaving a debit balance of $19,-685.93. The securities which remained in the account after the sale were worth $9,400. Thus there was a deficiency in the account before the purchase of the Montgomery Ward stock, of $10,285.93. On April 1, 1939, 300 shares of Montgomery Ward stock were acquired at a cost of $13,926, which was not paid until April 5, 1937, when the 300 shares were sold. (R. 154–155.)

As to counts 13 and 14 (R. 31–33), petitioner, on May 12 and 9, 1939, respectively, extended credit in the James Allio and Faux accounts for longer periods than were allowed by Section 4 (a) and (c) of Regulation T (see pp. 28–30, *infra*). These transactions consisted of "free riding" the securities involved; both the May 9 and 12 purchases were paid for on May 22 by liquidation of the very securities purchased on the two earlier dates. (R. 67, 155, 156.)

In addition to the specific proof outlined above, there was evidence that on many occasions petitioner was cautioned by the Chicago office manager that numerous transactions in the Allio accounts were violative of the "Securities Act" and of Regulation T (R. 54, 56, 57–60; see also R. 79–80). Also, the record is replete with instances of false documents issued by petitioner and instances in which he sought to have matters deleted from his firm's records or kept from being placed therein (R. 52, 53, 58). Some of these documents he admitted were false (R. 203, 204). One his attorney admitted to be false (R. 206–207). Others were internally inconsistent and bear evidence of falsity on their face (R. 144, 204, 207).

ARGUMENT

I

Petitioner contends generally (Pet. 9–14) that the evidence was insufficient to support the verdict. He argues specifically that there was no

misappropriation of either the $10,000 or the $5,000 bond belonging to Mrs. Sweeney because, in effect, the transactions in connection with them were consummated with Mrs. Sweeney's knowledge and consent. He asserts also that there was an insufficiency of evidence to support counts 10 to 14, and especially count 12, in that as to the latter count the court below was guilty of an error of omission in failing to take into account certain transactions which, had they been considered, would have shown that petitioner was innocent of any wrongdoing. There is no merit in these contentions.

The evidence, summarized in the Statement, *supra,* pp. 4–13, shows that petitioner set about deliberately to defraud Mrs. Sweeney and that he knowingly transgressed Regulation T in his manipulations of the accounts of both of the Allios, of Faux, and of Mrs. Sweeney. In respect of the fraud counts, 1 to 9, the proof is clear that petitioner knew Mrs. Sweeney was unfamiliar with dealings in securities and was untutored in business affairs generally. He gained her confidence and knew that he had it. It was a very simple matter for him to take advantage of her ignorance and to prevail upon her to turn over to him money and the bonds in question when and as he desired. Government witnesses testified that the proceeds from the sales of the bonds were not returned to Mrs. Sweeney's account (see p. 6, *supra*). If petitioner had had honest intentions in dealing with

the bonds, there would have been no necessity for the various manipulations of the moneys accruing from the sales of the bonds, i. e., the crediting of the proceeds of the sale of the $10,000 bond to the Allio account to wipe out petitioner's losses, the depositing of the money from the sale of the $5,000 bond in the firm account of petitioner's wife, the subsequent depositing of the money in petitioner's personal bank account, the paying of petitioner's personal bank loan with part of the proceeds and the purchase of a half interest in certain real estate with another part. Moreover, petitioner's handling of the bonds can not be dissociated from the other aspects of his fraudulent scheme, viz, the excessive overtrading in Mrs. Sweeney's account for the purpose of gaining commissions, and the sale to her of firm-owned stocks of doubtful value at exhorbitant prices. As the court below summed up this aspect of the case, petitioner "in bad faith and in violation of his fiduciary duties, without regard to the market conditions and prices and without regard to the net worth of her account, the limitations of law and the rules of the New York Stock Exchange pertaining thereto, * * * bought and sold, at her risk, stocks and bonds and obligated her to pay, to his personal profit, commissions and fees" (R. 253). Petitioner's conduct in thus abusing his fiduciary position for his own profit was clearly in transgression of the mail fraud

statute and the fraud provisions of the Securities Act of 1933. *Pandolfo* v. *United States,* 128 F. (2d) 917 (C. C. A. 10), certiorari denied, October 12, 1942, No. 223, this Term; *Glover* v. *United States,* 125 F. (2d) 291 (C. C. A. 5), certiorari denied, 316 U. S. 690; *United States* v. *Groves,* 122 F. (2d) 87, 90 (C. C. A. 2), certiorari denied, 314 U. S. 670; *Leche* v. *United States,* 118 F. (2d) 246 (C. C. A. 5), certiorari denied, 314 U. S. 617; *Shusan* v. *United States,* 117 F. (2d) 110, 115 (C. C. A. 5), certiorari denied, 313 U. S. 574; *United States* v. *Buckner,* 108 F. (2d) 921, 926, 927 (C. C. A. 2), certiorari denied, 309 U. S. 669.

In respect of the violations of Regulation T, the evidence is clear that petitioner "matched" or "kited" checks and that he "free rode" securities. He was constantly pressed to supply margin in the Allio accounts by the Chicago office manager (R. 57–60; see also R. 86–87), a result that hardly would have taken place had he not been extending credit beyond the limits allowed by law. Also, he was warned frequently concerning the illegal aspect of his trading and was himself aware of it (R. 54, 56, 57–60, 79–80). He knew well the extent of Allio's financial responsibility as well as of his own. His trading was at a rate and volume far in excess of the limits permissible to one of such limited responsibility. The rapid turnover of securities, the in and out

trading, the large volume, are all indicative of trading on credit and were necessitated by the demands for the margin required by law. As to the evidence in connection with count 12 relied upon by the court below (R. 254) and challenged by petitioner (Pet. 9), it is sufficient to point out that the court's summation is a substantial reproduction of the testimony of Government witness Young (R. 154–155). Petitioner can not complain that the jury believed the testimony of the Government witness and failed to give credence to what petitioner claims is the correct analysis of the transactions.

Moreover, in respect of the entire case, petitioner's general conduct must be taken into account. He falsified records and letters, sought to delete items from some records and to destroy others, and attempted to keep incriminating facts from appearing on the records (R. 52, 53, 58, 66, 133, 140–141, 203–204). Such conduct is incompatible with petitioner's claim of innocence and good faith. In the light of all the testimony the case was preeminently one for the determination of the jury on all the counts.

Finally, since, as we have shown (*supra*, pp. 5–10) and as the court below indicated (R. 158), the evidence was amply sufficient to support the fraud counts and since the general sentence of five years' imprisonment imposed upon petitioner did not exceed the maximum which might have been imposed under any of those, the alleged insuf-

ficiency of the evidence to support the remaining counts is immaterial on appeal. *Whitfield* v. *Ohio*, 297 U. S. 431, 438; *United States* v. *Trenton Potteries*, 273 U. S. 392, 402; *Brooks* v. *United States*, 267 U. S. 432, 441; *Pierce* v. *United States*, 252 U. S. 239, 252–253; *Abrams* v. *United States*, 250 U. S. 616, 619; *Claassen* v. *United States*, 142 U. S. 140, 146–147.

II

In respect of counts 10 to 14, petitioner also contends (Pet. 7–8) that the provisions of the Securities Exchange Act of 1934, which confer upon the Board of Governors of the Federal Reserve System the power to issue regulations governing the extension of credit by brokers (Secs. 7 and 8, *infra*, pp. 22–25) and make it a criminal offense to violate such regulations (Sec. 32, *infra* p. 25) are an unconstitutional delegation of legislative power. This contention is untenable.

In the first place, as we have already said (*supra*, p. 17), the general sentence of five years' imprisonment imposed upon petitioner did not exceed the maximum imposable under any of the fraud counts (1 to 9), the legal sufficiency of which is not questioned; hence the claimed invalidity of the counts grounded upon the Securities Exchange Act and Regulation T is immaterial. (See cases cited at pp. 17–18, *supra*.)

Petitioner's contention is, in any event, without

merit. It is settled that Congress may delegate to an administrative agency power to promulgate rules and regulations to effectuate the legislative purpose, provided that Congress defines the general policy and establishes adequate and intelligible standards for the guidance and governance of administrative action. *Opp Cotton Mills* v. *Administrator of the Wage and Hour Division,* 312 U. S. 126, 142–146; *Sunshine Coal Co.* v. *Adkins,* 310 U. S. 381, 397–400; *United States* v. *Rock Royal Co-op.,* 307 U. S. 533, 574–577; *Mulford* v. *Smith,* 307 U. S. 38, 48–49; *Currin* v. *Wallace,* 306 U. S. 1, 16–18; *Radio Comm'n* v. *Nelson Bros. Co.,* 289 U. S. 266, 285; *United States* v. *Shreveport Grain & El. Co.,* 287 U. S. 77, 85; *N. Y. Central Securities Co.* v. *United States,* 287 U. S. 12, 24–25; *Hampton & Co.* v. *United States,* 276 U. S. 394, 406–411; *Avent* v. *United States,* 266 U. S. 127, 130–131; *United States* v. *Grimaud,* 220 U. S. 506, 516–518. And it is equally clear that Congress may make violation of the administrative regulations a crime. *Opp Cotton Mills* v. *Administrator of the Wage and Hour Division,* 312 U. S., at 134, 142–146; *United States* v. *Shreveport Grain & El. Co.,* 287 U. S., at 85; *Avent* v. *United States,* 266 U. S., at 131; *United States* v. *Grimaud,* 220 U. S., at 515, 517, 518; *Cerritos Gun Club* v. *Hall,* 96 F. (2d) 620 (C. C. A. 9); cf. *Mulford* v. *Smith,* 307 U. S., at 44, 48–49; *Currin* v. *Wallace,* 306 U. S., at 7, 16–18.

The provisions of the Securities Exchange Act here assailed meet all the tests laid down in the cases. The legislative policy to prevent the excessive use of credit for the purchase or carrying of securities is explicitly stated in Section 7 (a) of the statute (*infra,* p. 22) and the standards for administrative action are set forth clearly and in detail (*infra,* pp. 22–25). To use the language of this Court in *Sunshine Coal Co.* v. *Adkins,* 310 U. S., at 398, "The standards which Congress has provided here far exceed in specificity others which have been sustained. Certainly in the hands of experts the criteria which Congress has supplied are wholly adequate for carrying out the general policy and purpose of the Act."

CONCLUSION

The decision below is correct, and there is involved no conflict of decisions or question of general importance. We respectfully submit, therefore, that the petition for a writ of certiorari should be denied.

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J. BENSON SAKS,
Attorneys.

FEBRUARY 1943.

APPENDIX

The mail fraud statute (Section 215 of the Criminal Code, 18 U. S. C. 338) provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, * * * shall, for the purpose of executing such scheme or artifice or attempting so to do, place, or cause to be placed, any letter, postal card, package, writing, circular, pamphlet, or advertisement, whether addressed to any person residing within or outside the United States, in any post office, or station thereof, or street or other letter box of the United States, or authorized depository for mail matter, to be sent or delivered by the post-office establishment of the United States, or shall take or receive any such therefrom, whether mailed within or without the United States, or shall knowingly cause to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such letter, postal card, package, writing, circular, pamphlet, or advertisement, shall be fined not more than $1,000, or imprisoned not more than five years, or both.

Sections 17 (a) and 24 of the Securities Act of 1933, (48 Stat. 74, 84–85, 87; 15 U. S. C. 77q (a), 77x) provide in part:

> Sec. 17. (a) It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, * * *.
>
> * * * * *
>
> Sec. 24. Any person who willfully violates any of the provisions of this title, * * * shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both.

Sections 7, 8, and 32 of the Securities Exchange Act of 1934 (48 Stat. 881, 886–889, 904–905; 15 U. S. C. 78g, 78h, 78ff (a)) provide in part:

> Sec. 7. (a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Federal Reserve Board shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security) registered on a national securities exchange. For the initial extension of credit, such rules and regulations

shall be based upon the following standard: An amount not greater than whichever is the higher of—

(1) 55 per centum of the current market price of the security, or

(2) 100 per centum of the lowest market price of the security during the preceding thirty-six calendar months, but not more than 75 per centum of the current market price.

Such rules and regulations may make appropriate provision with respect to the carrying of undermargined accounts for limited periods and under specified conditions; the withdrawal of funds or securities; the substitution or additional purchases of securities; the transfer of accounts from one lender to another; special or different margin requirements for delayed deliveries, short sales, arbitrage transactions, and securities to which paragraph (2) of this subsection does not apply; the bases and the methods to be used in calculating loans, and margins and market prices; and similar administrative adjustments and details. * * *.

(b) Notwithstanding the provisions of subsection (a) of this section, the Federal Reserve Board, may, from time to time, with respect to all or specified securities or transactions, or classes of securities, or classes of transactions, by such rules and regulations (1) prescribe such lower margin requirements for the initial extension or maintenance of credit as it deems necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country, and (2) prescribe such higher margin re-

quirements for the initial extension or maintenance of credit as it may deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities.

(c) It shall be unlawful for any member of a national securities exchange or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—

(1) On any security (other than an exempted security) registered on a national securities exchange, in contravention of the rules and regulations which the Federal Reserve Board shall prescribe under subsections (a) and (b) of this section.

(2) Without collateral or on any collateral other than exempted securities and/or securities registered upon a national securities exchange, except in accordance with such rules and regulations as the Federal Reserve Board may prescribe (A) to permit under specified conditions and for a limited period any such member, broker, or dealer to maintain a credit initially extended in conformity with the rules and regulations of the Federal Reserve Board, and (B) to permit the extension or maintenance of credit in cases where the extension or maintenance of credit is not for the purpose of purchasing or carrying securities or of evading or circumventing the provisions of paragraph (1) of this subsection.

* * * * *

SEC. 8. It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a business in securities through the medium

of any such member, directly or indirectly—

(a) To borrow in the ordinary course of business as a broker or dealer on any security (other than an exempted security) registered on a national securities exchange except * * * (3) in accordance with such rules and regulations as the Federal Reserve Board may prescribe to permit loans between such members and/or brokers and/or dealers, or to permit loans to meet emergency needs.

* * * * *

SEC. 32. Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, * * * shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

The pertinent provisions of Regulation T, promulgated by the Board of Governors of the Federal Reserve System, pursuant to Sections 7 and 8 of the Securities Exchange Act of 1934, *supra,* read as follows (Code of Federal Regulations, Title 12, Part 220, pp. 1000–1005, 1011):

SECTION 3. GENERAL ACCOUNTS. (a) Contents of general account.—All financial relations between a creditor and a customer, whether recorded in one record or in more than one record, shall be included in and be

deemed to be parts of the customer's general account with the creditor, except that the relations which section 4 permits to be included in any special account provided for by that section may be included in the appropriate special account, and all transactions in commodities for or with any customer shall be included in the special commodity account provided for by sections 4 (a) and 4 (e).

(b) General rule.—A creditor shall not effect for or with any customer in a general account any transaction which, in combination with the other transactions effected in the account on the same day, creates an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account, or increases any such excess, unless in connection therewith the creditor obtains, as promptly as possible and in any event before the expiration of three full business days following the date of such transaction, the deposit into the account of cash or securities in such amount that the cash deposited plus the maximum loan value of the securities deposited equals or exceeds the excess so created or the increase so caused.

A transaction consisting of a withdrawal of cash or registered or exempted securities from a general account shall be permissible only on condition that no cash or securities need be deposited in the account in connection with a transaction on a previous day and that, in addition, the transactions (including such withdrawal) on the day of such withdrawal would not create an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account or increase any such excess.

* * * * *

(e) Liquidation in lieu of deposit.*—In any case in which the deposit required by section 3 (b), or any portion thereof, is not obtained by the creditor within the three-day period specified in that section, securities shall be sold or covering or other liquidating transactions shall be effected in the account, prior to the expiration of such three-day period, in such amount that the resulting decrease in the adjusted debit balance of the account exceeds, by an amount at least as great as such required deposit or the undeposited portion thereof, any resulting decrease in the maximum loan value of the securities in the account.

* * * * *

(g) Transactions on given day.—For the purposes of section 3 (b), the question of whether or not an excess of the adjusted debit balance of a general account over the maximum loan value of the securities in the account is created or increased on a given day shall be determined on the basis of all the transactions in the account on that day exclusive of any deposit of cash, deposit of securities, covering transaction or other liquidation that has been effected on the given day, pursuant to the requirements of section 3 (b) or 3 (e), in connection with a transaction on a previous day.

* * * * *

---

*This requirement relates to the action to be taken when a customer fails to make the deposit required by section 3 (b), and it is not intended to countenance on the part of customers the practice commonly known as "free-riding" or "three-day riding", to prevent which the principal national securities exchanges have adopted certain rules. See the rules of such exchanges and section 7 (e) of this regulation.

SECTION 4. SPECIAL ACCOUNTS. (a) General rule.—Pursuant to this section 4, a creditor may establish for any customer one or more special accounts.

Each such special account shall be recorded separately and shall be confined to the transactions and relations specifically authorized for such account by the appropriate subsection of this section and to transactions and relations incidental to those specifically authorized. An adequate record shall be maintained showing for each such account the full details of all transactions in the account.

A special account established pursuant to this section shall not be used in any way for the purpose of evading or circumventing any of the provisions of this regulation. If a customer has with a creditor both a general account and one or more such special accounts, the creditor shall treat each such special account as if the customer had with the creditor no general account.

The only other conditions to which transactions in such special accounts shall be subject under the provisions of this regulation shall be such conditions as are specified in the appropriate subsection of this section and in sections 2, 6 and 7.

* * * * *

(c) Special cash account. (Provisions of January 1, 1938, to May 21, 1939.)—In a special cash account, a creditor may effect for or with any customer bona fide cash transactions in securities in which the creditor may—

(1) purchase any security for, or sell any security to, any customer, provided funds sufficient for the purpose are already held in the account or the purchase or sale is in reliance upon an agreement accepted by the

creditor in good faith that the customer will promptly make full cash payment for such security; or

(2) sell any security for, or purchase any security from, any customer, provided the security is held in the account or the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the security is to be promptly deposited in the account.

(c) Special cash account. (As amended May 22, 1939.)—(1) In a special cash account, a creditor may effect for or with any customer bona fide cash transactions in securities in which the creditor may—

(A) purchase any security for, or sell any security to, any customer, provided funds sufficient for the purpose are already held in the account or the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the customer will promptly make full cash payment for the security and that the customer does not contemplate selling the security prior to making such payment; or

(B) sell any security for, or purchase any security from, any customer, provided the security is held in the account or the creditor is informed that the customer or his principal owns the security and the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the security is to be promptly deposited in the account.

(2) In case a customer purchases a security (other than an exempted security) in the special cash account and does not make full cash payment for the security within 7 days after the date on which the security is so purchased, the creditor shall, except as

provided in the succeeding subdivisions of this section 4 (c), promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof.

* * * * *

Supplement to Regulation T
Issued by the Board of Governors of the Federal Reserve System

Effective January 1, 1938

Maximum loan value for general accounts.—The maximum loan value of a registered security (other than an exempted security) in a general account, subject to section 3 of Regulation T, shall be 60 per cent of its current market value.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1943

(3)

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

No. 632

RUSSELL W. McDERMOTT,

Petitioner,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR REHEARING ON THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

EBEN LESH,
Huntington, Indiana,
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Huntington, Indiana,
Of Counsel.

THE SUNTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

INDEX TO BRIEF.

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PETITION.

For the reasons set out in our petition for a writ of certiorari to the United States Circuit Court of Appeals for the seventh Circuit and upon the grounds therein set forth, we respectfully pray the Court to grant a Re-hearing on said petition and grant the writ of certiorari as therein prayed for.

In support of this petition for a re-hearing we herewith submit a brief appended hereto and by reference made a part of this petition for rehearing.

BRIEF.

The opinion of the Circuit Court of Appeals found in the Record on pages 252 to 258, inclusive, adopts certain arguments of the Government upon which the judgment of the Circuit Court of Appeals is based which are not only unsupported by the evidence in the Record but are definitely contradicted by the clear and convincing proof as shown by the Record.

As a basis for a clear understanding of these points it is necessary to say that Marie Langen Sweeney, a customer of the brokerage firm of Moore, McLean & McDermott, of which the Petitioner McDermott was a member, did trading with the firm under the fictitious name of K. K. Kado and also carried another account with the firm under the name of James Allio.

The reason for carrying two accounts was to enable her to carry one account as a cash account and another account as a margin account. The reason for not using her own name in connection with these accounts had its origin with Mrs. Sweeney herself.

Prior to that time, her husband Allan Sweeney had conducted extensive trading with various brokerage firms, which trading had been conducted under her name and at her risk, and in which amounts aggregating approximately $100,000 of her money had been lost. All of these transactions had been done by her husband Allan Sweeney on his judgment and for which no blame was or could be charged against the petitioner, McDermott. This trading on the part of Allan Sweeney had its origin with the firm of Atkins, Hammel & Gates and later with Thompson & McKinnon and still later with the firm of Moore, McLean & McDermott, but under the direct supervision of a member of the firm other than McDermott. When it came to

the attention of the petitioner McDermott that this trading was going on at such a rapid pace and with such terrific losses, McDermott called Mrs. Sweeney into the office of the firm, informed her of the volume of trading and recommended to her to close the account. (R. 177, 111 to 112, 88.) In the course of this conversation between the Petitioner McDermott and Mrs. Sweeney it was determined to close out the old account which was being conducted by her husband Allan Sweeney and open new accounts for Mrs. Sweeney to be conducted on a more conservative basis and under more experienced guidance, and at the suggestion of Mrs. Sweeney, names other than her own were to be used to designate the accounts. We quote from the testimony of Mrs. Sweeney upon the subject as follows: "Well, one thing, if I do carry on an account I don't want it in my name nor do I wish the transactions or papers to be sent to the home." (R. 99.) This was further elaborated and confirmed by additional testimony of Mrs. Sweeney which is found on pages 7 to 10 in Petitioner's original brief filed in the Circuit Court of Appeals and more fully found in the Record on pages 101, 102, 112, 113, 116, 172. These Record references will show conclusively the knowledge of Mrs. Sweeney of the fact that the K. K. Kado account and the James Allio account were her accounts carried for her use and at her risk and that the same was done with her knowledge and consent and at her request, and the practice of carrying accounts in names other than that of the party in interest, is not only a lawful practice but one that is common with all brokerage houses and has never been condemned or even criticized.

With the above explanation which is borne out by the Record by the evidence adduced by the Government and not in any way contradicted, we now go to the findings of the Circuit Court of Appeals evidently based upon a failure to consider these fundamentals, which findings are

in direct conflict with the facts clearly borne out by the uncontradicted evidences as follows:

1. The finding of the Circuit Court of Appeals that there was a misappropriation of United States Treasury Bond 31022B, par value $10,000, sale value $11,211.12.

The Evidence.

The evidence shows clearly that this bond was acquired by the Defendant, not on April 7, 1939, as stated in the opinion, but in October, 1938, and for the specific purpose to which it was applied at the time of sale, and to support this assertion we refer to the following:

A. The written receipt for the bond signed by Mr. McDermott and given to Mrs. Sweeney is in evidence as Government's Exhibit 518 and Defendant's Exhibit 2, and reads as follows:

> "October, 1938. Mrs. Marie Langen Sweeney. Received $10,000 Tr 3¼-46-44 to be held and used by Mr. McDermott for collateral purposes in account known as Jas. Allio or other he may see fit for trading purposes. This bond to be held in Mr. McDermott's possession and not sold until ordered by me unless otherwise it becomes necessary to do so because of market conditions. Understood Richardson McVey auditors will make up audit periodically as see fit to do so. R. McDermott." (Government's Ex. 518, Defendant's Ex. 2.)

B. Concurrently with the giving of said receipt Mrs. Sweeney gave to the Defendant written authorization relating thereto over her signature which appears in evidence as Defendant's Exhibit 3, reading as follows:

> "October, 1938. R. D. McDermott, 40 N. Penn. Indpl. This is giving you authority to use the 10 M Tr Bond for Trading purposes as you may see fit. Satisfactory to use Jas. Allio or others you may suggest. Also agreed to notify Richardson McVey

C. P. A. when activities start and audit be made periodically. Marie Langen Sweeney." (Defendant's Ex. 3.)

C. Mrs. Sweeney in her testimony states as follows: "I don't know whether the receipt mentioned James Allio or not," and after refreshing her recollection from the receipt she further testified:

> "I know James Allio was mentioned afterwards but I don't recall whether it was mentioned at that time or not." (R. 112, 113.)

The witness Richardson testified that he made an audit of the accounts carried in the names of K. K. Kado, James Allio, Philip Allio, and Russell Faux, and that he furnished a copy of the audit to Mrs. Sweeney and that he later discussed the audit with Mrs. Sweeney. (R. 171.) He then testified as follows:

> "At the time I wrote the transmittal letter I knew these accounts belonged to Mrs. Sweeney. I learned that from Mr. McDermott and had it confirmed by Mrs. Sweeney over the telephone." (R. 172.)

It therefore appears clear that the application of the bond herein described or its proceeds to the James Allio account was strictly in conformity to the purpose for which it was held and did not and could not constitute a misappropriation of the bond or its proceeds.

2. The finding of the Circuit Court of Appeals that there was a misappropriation of United States Treasury Bond 1199-K, face value $5,000.

The Evidence.

The undisputed evidence upon this subject as shown by the testimony of Mrs. Sweeney, the owner of the bond, was as follows:

> "There was some discussion with Mr. McDermott that day about making some investment in Christ

Church bonds. The talk was that the Church bonds would be bought under par and were paying a better rate of interest than the government bonds. McDermott advised me that $4,000 of government bonds would buy $5,000 worth of Church bonds and he recommended this. No decision was reached that day. Something was said about some of my bonds being put in Cecelia McDermott's account.

Q. Was it your suggestion that one of these bonds might be sold and the proceeds kept available to determine whether or not you should purchase these Church bonds?

A. It wasn't my suggestion. It was Mr. McDermott's suggestion. He asked if it would be all right to do it.

Q. Was that agreed to between you and him?

A. Yes, sir." (R. 118.)

She further testified upon this subject as follows:

"For a period then I didn't talk much to Mr. McDermott as he was in Chicago on account of his father's illness. When I couldn't make up my mind what I wanted to do with the bond in Cecelia McDermott's account I said I wished him to purchase a government bond, instead of the Christ Church bonds, and he bought government bonds with it and turned them over to me. That was some time in June, the first time I had been to his office." (R. 119.)

The receipt of Mrs. Sweeney for the substituted bonds was as follows:

"..... 1939: 'Received from Mrs. McDermott the following Treasury 3¼s; 81874D, 4472B, 4473C, 4474D, and 4475E.'

The Court: Does that show where they came from?

The Witness: It says on this receipt: 'These to replace the $5,000 bond sold in Cecelia McDermott's account per my instruction Good Friday.' Signed, 'Marie Langen Sweeney.'" (R. 174.)

Assuming that there was some evidence in the Record to sustain the holding of the Circuit Court of Appeals that the proceeds from the sale of Bond Number 1199K

were used in part to purchase an interest in certain lots in Marion County, Indiana, and in part to pay defendant's indebtedness to another bank at Indianapolis, (a matter about which there was direct conflict in the testimony) there was no conflict whatever in the testimony of Marie Langen Sweeney that the identical amount of actual Treasury bonds and of the same issue was restored to her in kind on the occasion of her first visit to the office of the petitioner, McDermott, after the sale of the original bond.

In the light of the above, what matters it whether the contention of the government is correct that there had been an intervening use of the money to buy real estate and pay personal indebtedness, or the contention of the petitioner is correct that the money had all the time remained in the account of Cecelia McDermott, carried with Moore, McLean, and McDermott.

To still further support the contention that the evidence shows that there was no misappropriation of either of these bonds mentioned in paragraphs one and two we cite Government's Ex. 519, being a communication addressed by Marie Langen Sweeney to Mr. Russell McDermott under date of April 9, 1941 which was nearly two years after the trading had ceased and which reads as follows:

"Indianapolis, Indiana,
April 9, 1941.

Mr. Russell McDermott,
City.

DEAR MR. MCDERMOTT:

Up to the fall of 1938, my husband, Mr. Allen Sweeney, handled my marginal account and incurred such losses that I decided to handle it myself. As Mr. Sweeney had been conducting business with the firm of Moore, McLean, and McDermott, I continued it with you, and gave you the customary power of attorney to act upon my behalf. This was in or

about the month of October, 1938. I did not want the account carried in my name, nor did I want communications and reports to come to my apartment. The account was therefore carried in the name of K. K. Kado, and reports were mailed to K. K. Kado in care of Stationers, Inc., whose place of business is next to that of Moore, McLean and McDermott. It was understood that I should call for such communications at any time that I pleased.

The transactions in the account resulted in a loss. These were due to a continuous declining market, and through no fault, mishandling, or dishonest act on your part. Every transaction was accounted for, and the entire account was audited by Richardson & McVey, of this city, and everything was found straight and satisfactory.

Inasmuch as particular question has been raised relative to the purchase and sale of the United States Treasury Bonds, I wish to assure you that all of my Treasury Bonds which were turned over to you, and all proceeds, have been fully and accurately accounted for. S. E. C. Investigators questioned me closely as to this account. I could not answer their questions fully and satisfactorily for the reason that I did not have all records and receipts with me. Since the time that they questioned me, I have located one receipt for $10,000.00 of Treasury Bonds, given to me by Mr. McDermott in October of 1938, such bonds to be used as collateral on the James Allio account. This account was set up with my knowledge and consent.

I am, and at all times have been, satisfied that I have received every penny that was owing me by you and your firm.

Yours very truly,

Signed MARIE LANGEN SWEENEY."

This letter was written nearly two years after the account of Marie Langen Sweeney had been closed, and sufficient length of time had elapsed to make any discovery of which she might have been ignorant at the time the account was closed. She had been interviewed by the S. E. C., as the letter so states, and she was fully informed

with respect to all of the matters covered by the letter. She had full knowledge of the disposition of the $10,000 Treasury Bond referred to in the opinion of the Circuit Court of Appeals and every fact that is germane to the case was fully known to her.

The introduction of this letter by the government instead of the defendant took away much of its force before the jury, and it was no doubt for this purpose that the government introduced the exhibit, but certainly the fact that it was introduced by the government instead of the defendant should not detract from its force and effectiveness before this court.

3. The holding of the Circuit Court of Appeals that the James Allio account was under-margined as charged in Counts 10 to 14, inclusive, of the indictment, and particularly Count 12 thereof.

The Evidence.

As stated in our original Petition for Writ of Certiorari on page 9, this holding is based upon two errors or oversights on the part of the Circuit Court of Appeals to take into account certain vital facts that are omitted in the computation appearing in the opinion as follows: By Government's Ex. 11-K it is shown that on the 31st day of March, 1939 a deposit to the account of James Allio was made in the amount of $8,000 which deposit is entirely ignored in the computation set out in the opinion and in addition thereto the opinion entirely ignores the fact that United States Treasury Bond 31022B in the face amount of $10,000 but of the actual cash value of $11,211.12 was at all times held for the protection of the account. If these two facts, which the Circuit Court of Appeals' opinion ignores are taken into account it is perfectly clear that there was no time at which the

account was ever under-margined below the requirements of the regulations of the Board of Governors of the Federal Reserve.

It is true that government's witness Holland stated in his oral testimony over and over again that the James Allio account was frequently "under water" (a term used by the witness as meaning under-margined) but when confronted by actual facts and figures his testimony upon the subject boiled down to this:

> "Q. Now you talked about this account being 'under water' (a term used by the witness as meaning under-margined) constantly, and I think you said at one time it got up to a point where it was eight thousand dollars under water, did you not?
>
> A. I think I said a maximum of eighty-five hundred.
>
> Q. Eight five hundred dollars. Now, assuming that this ten thousand dollar bond, 31022B, that was subsequently sold for in excess of eleven thousand dollars, had been in the Indianapolis guaranteeing that account, from October until April 8th, when it was sold, that condition about the account being 'under water' would not have existed? Isn't that correct?
>
> A. That is true." (R. 89.)

4. The holding of the Circuit Court of Appeals that trading in the James Allio account was by virtue of a system of buying securities and selling the same securities to pay for their purchase and concealing this by an exchange of checks in substantially equal sums. A witness described this practice as "matching checks", "check kiting" and "free riding".

The Evidence.

It is a fact that running all through the testimony of government's witness Holland is a train of instances characterized by the witness as the "matching of checks" and sometimes referred to as "check kiting" and numerous

instances are recited by the witness where checks of similar or nearly similar amounts were given by James Allio to the firm and by the firm to Allio on or near the same day. These instances are described on pages 54, 55, 56, 59, 61, 64, 65, 89 and 96 of the Record, but in Petitioner's original brief to the Circuit Court of Appeals, beginning on page 17 and ending on page 21 of said brief, every instance characterized by the witness Holland as constituting a transaction of "matching checks" or "kiting checks" is analyzed in detail from the exhibits introduced by the government, and every check payable from the firm to the Allio account is shown to represent the net sale price of a security actually sold out of the Allio account and every check payable from Allio to the firm is shown to represent the actual purchase price of a security purchased into the account.

We have analyzed each one of these transactions from the original exhibits from pages 17 to 21 inclusive of our former brief, and we say without fear of successful contradiction that there is not a single instance in the Record where there was any "check matching" or "check kiting" within the obnoxious meaning of the law. It is our understanding that Petitioner's original brief in the Circuit Court of Appeals has been certified to this Court and is available for the consideration of this Court and we most earnestly urge and request this Court to refer to said brief on pages 17 to 21 for further enlightenment upon this subject. We also call attention to the direct testimony of the witness Holland, upon whose testimony the whole fabric of "check matching" and "check kiting" is builded, as follows:

> "The defendant did not ever give any one a check when there wasn't sufficient money in the bank to meet it. If there was any "check matching" in the Allio account it was done by James Allio and not by the defendant." (R. 89.)

Conclusion.

We are not unmindful of the hesitancy of Courts to grant rehearings, nor are we unmindful of the reluctance to grant writs of certiorari where questions of public interest are not involved, but we do feel that where the life or liberty of a citizen of the United States is at stake and the absence of any criminal intent is as clear as it is in the case at bar, this Court will not be bound in the exercise of its discretionary right by any limitation, but will do justice where justice has failed in the trial Court, and we earnestly pray that a rehearing be granted herein and that the Petition for the Writ of Certiorari be granted as prayed for.

Respectfully submitted,

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